

Office of Chief Counsel  
Internal Revenue Service  
**Memorandum**

Number: **200926001**

Release Date: 6/26/2009

CC:PA:03:WLKribell

GL-136340-08

UILC: 6331.00-00

date: January 09, 2009

to: Donald A. Glasel  
General Attorney (Long Island, Group 1)  
(Small Business/Self-Employed)

from: Mitchel S. Hyman  
Senior Technician Reviewer, Branch 3  
(Procedure & Administration)

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subject:

This Chief Counsel Advice responds to your request for assistance dated October 20, 2008. This advice may not be used or cited as precedent.

Legend

Taxpayer	=
Title	=
Company A	=
Company B	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
Date 5	=
Date 6	=
Date 7	=
Date 8	=
Amount 1	=
Amount 2	=
Amount 3	=
Amount 4	=

Amount 5        =  
Amount 6        =  
Year 1           =

## **ISSUE**

Whether the IRS can enforce a regular levy served on the Taxpayer by seizing and selling executive stock options held by the Taxpayer.

## **CONCLUSION**

The IRS can seize and sell executive stock options held by the Taxpayer regardless of restrictions on the transferability of the options.

## **FACTS**

The Taxpayer was the Title of Company A. As part of the Taxpayer's Employment Agreement with Company A, the Taxpayer was granted executive stock options ("Options") to shares of Company A common stock ("Stock") under both a Non-Qualified Stock Option Plan ("NQSO Plan") and an Incentive Stock Option Plan ("ISO Plan").

Options granted under the ISO Plan were intended to be "incentive stock options" pursuant to section 422. ISO Plan Options were intended to be granted only to key executives and key employees of Company A and were subject to the limitations of section 422(d).

Transferability of ISO Options was only permitted by will, the laws of descent or distribution, or pursuant to a qualified domestic relations order ("QDRO"). During the Taxpayer's the ISO Options could only be exercised by the Taxpayer, his guardian or legal representative, or the Taxpayer's transferee pursuant to a QDRO.

The NQSO Plan provides that Options are exercisable by written notice to Company A ("Notice"). The Notice must be accompanied by payment of the full purchase price of the shares. Company A will then deliver certificates representing shares of Company A purchased pursuant to the Notice as soon as practicable after receipt of the Notice. The rules governing transferability of the NQSO Options are substantially the same as the rules governing the ISO Options.

The Taxpayer's employment with Company A was terminated pursuant to a Separation Agreement dated Date 1 ("Termination Date"). Among other thing, the Separation Agreement provided that Company A would allow the Taxpayer's rights to the Options to vest as of the Termination Date.

A Revenue Office served a Notice of Levy on Wages, Salary and Other Income ("Form 668-W"), dated Date 2, on Company A. The Revenue Officer also served a Notice of Levy ("Form 668-A"), dated Date 3, on Company A. Both the Form 668-W and the

Form 668-A reflect the tax liability. The taxpayer was given his CDP rights after filing of the NFTLs and prior to the service of the Forms 668-W and 668-A. The CDP rights were not exercised.

Taxpayer and Company A entered into an arbitration hearing in Year 1 to determine, among other things, the validity of the Options. On Date 4, the Taxpayer and Company A agreed in principle to settle the legal claims each brought against the other. Included in the Settlement Agreement are the following terms:

1. Company A will comply with any and all liens, judgments, restraining notices, garnishments, levies, and other similar forms of legal process against or relating to the Taxpayer that it has received and/or may in the future receive.
2. Company A will cancel Amount 1 options of the Amount 2 disputed options and will not contest the Taxpayer's right to exercise the remainder. However, any election on the part of the Taxpayer to exercise these options shall be subject to liens and judgments against the Taxpayer, including the above-referenced Notice of Levy and any other federal tax liens in favor of the United States that have attached to Taxpayer's property and property rights.

Additionally, Company A informed the IRS that the Taxpayer owns Amount 3 vested options to acquire Company A's common stock at a strike price of \$Amount 4 per share. The Options expire Date 5.

Company B agreed to buy Company A for \$Amount 5 per share on Date 6. On Date 7, Company B announced that its acquisition of Company A would be completed on Date 8, and that any outstanding shares of Company A not purchased in the tender offer would be converted into a right to receive \$Amount 5 per share in cash. It is unclear whether the right to convert outstanding shares into cash extends to vested stock options. At the offer price, the Taxpayer's Options, if still exercisable, are worth \$Amount 6. Company A was last listed on the New York Stock Exchange on Date 8.

## **LAW AND ANALYSIS**

### **I. THE TAXPAYER'S STOCK OPTIONS CAN BE SEIZED UNDER THE REGULAR LEVY SERVED ON COMPANY A IN YEAR 1.**

The federal tax lien that arises upon assessment of the tax and notice and demand for payment attaches to all of the taxpayer's property and rights to property. I.R.C. §§ 6321 and 6322. Congress broadly defined "property" to reach every interest a taxpayer might have in property. See United States v. National Bank of Commerce, 472 U.S. 713 (1985). Section 6331(a) of the Code authorizes the Service to collect delinquent taxes by levy on all property or rights to property of a taxpayer and on which there is a federal tax lien. I.R.C. §6331(a). Levy may be made upon any property or rights to property, real or personal, tangible or intangible, belonging to the taxpayer. Treas. Reg. §

301.6331-1(a). "Levy may be made by serving a notice of levy on any person in possession of, or obligated with respect to, property or rights to property subject to levy, including receivables, bank accounts, evidences of debt, securities, and salaries, wages, commissions or compensation.

Generally, a levy extends only to property held by the taxpayer or a third party at the time of the levy. Property received after the notice of levy is served can only be reached by a subsequent levy. I.R.C. §6331(b). However, a levy on wages and salary is a continuous levy until the tax liability covered by the levy is satisfied or becomes unenforceable because of a lapse of time. I.R.C. § 6331(e); Treas. Reg. § 301.6331-1(b).

Section 6332 and Treas. Reg. § 301.6332-1(a) provide that any person in possession of property or rights to property subject to levy and upon which a levy has been made shall, upon demand of the Service, surrender the property or rights to the Service. I.R.C. § 6332(a). There are only two defenses to failure to honor a levy: (1) the levy source is not in possession of or obligated with respect to the property of the taxpayer and (2) the property is subject to prior judicial attachment or execution.

In this case, the Taxpayer had a vested right to the Options as of the Date 1 Separation Agreement. The Taxpayer's property right in the Options thus arose on Date 1, and was in effect on Date 3, when the Notice of Levy was served on Company A. The Date 4 Settlement Agreement between the Taxpayer and Company A did not create a property right in the disputed options. It merely affirmed a property right already in existence.

## II. THE SERVICE CAN SELL THE TAXPAYER'S STOCK OPTIONS REGARDLESS OF RESTRICTIONS ON THE TRANSFERABILITY OF THE OPTIONS.

The Options are property rights subject to the seizure and sale procedures of section 6335. The restrictions on transfer of the Options applicable to the Taxpayer would not apply to the Service. Consequently, the Service can enforce the levy by selling the Options to a third party.

### A. Non-Qualified Stock Options

The majority of the Options held by the Taxpayer are non-qualified stock options for which the restrictions on transferability are contractual rather than statutory. Contractual restrictions on transferability do not bar the Service from seizing and selling property under the procedures of section 6335. Section 6331(a) gives the Service broad collection powers to levy on all property or rights to property belonging to the taxpayer. Section 6334(a) enumerates certain types of property that are exempt from levy under section 6331. These exemptions are clear and the courts will not infer any exemptions in addition to those set forth in that subsection. See Kane v. Burlington Savings Bank, 320 F.2d 545, 548 (2d Cir. 1963). Stock options are not included in the

exemptions from levy. The levy provisions of section 6331 supersede the contractual restrictions on transferability of the options. Therefore, the Service would not be prevented from selling the non-qualified options to a third party.

## B. Incentive Stock Options

In the case of the Taxpayer's incentive stock options, the restrictions on transferability required by section 422 are overridden by section 6334(c), which states that "[n]otwithstanding any other law of the United States . . . no property or rights to property shall be exempt from levy other than property specifically made exempt by subsection (a)."

The treatment of incentive stock options by the Service can be analogized to that of ERISA-qualified pension plans. Section 413(a) states that a pension plan will not be considered a qualified trust unless it provides that benefits under the plan may not be assigned or alienated. However, under ERISA and federal tax law, anti-alienation provisions enforceable under ERISA against creditors generally are not enforceable against the Service. Treas. Reg. § 1.403(a)-13(b)(2) (required anti-assignment or alienation clause does not preclude the enforcement of a federal tax levy made pursuant to section 6331). See also Shanbaum v. United States, 32 F.3d 180, 183 (5th Cir. 1994) (stating in dictum that a taxpayer's pension benefits under an ERISA-qualified plan are subject to levy despite the ERISA anti-alienation provisions).

While the anti-alienation provisions contained in ERISA are designed to preclude creditors from reaching pension benefits, as the Ninth Circuit explained in United States v. Snyder, 343 F.3d 1171, 1174 (9th Cir. 2003), "the IRS stands in a different position from ordinary creditors in that the anti-alienation provisions in ERISA-qualified pension plans are not enforceable against it." See also McIntyre v. United States, 222 F.3d 655, 660 (9th Cir. 2000). While ERISA expressly provides that it "shall [not] be construed to alter, amend, modify, invalidate, impair, or supersede any law of the United States," 29 U.S.C. § 1144(d), such a clause is not necessary to allow the Service to levy an ERISA-qualified pension plan because of the overarching language of sections 6331 and 6334. The Service can levy any property or property interest except where specifically exempted by 6334(a).

Section 422, addressing incentive stock options, contains a provision similar to that of section 413(a). To be a qualified incentive stock option, the option by its terms must not be "transferable by such individual otherwise than by will or the laws of descent and distribution. . . ." I.R.C. § 422(a)(5). As with the ERISA-qualified plans, the Options at issue here are unquestionably a property right in the hands of the Taxpayer subject to levy. As a result, the Service is not bound by the restrictions on transferability applicable to the Taxpayer and levy may be enforced by the sale of the incentive stock options to a third party.

**CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS**

[REDACTED]

[REDACTED]

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Please call \_\_\_\_\_ at \_\_\_\_\_ if you have any further questions.

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